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IN THE

Supreme Court of the United States

OCTOBER TERM, 1942

No. 792

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

GOOCH MILLING & ELEVATOR COMPANY.

On Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Eighth Circuit.

BRIEF FOR GOOCH MILLING & ELEVATOR COMPANY IN OPPOSITION.

F. W. MCREYNOLDS,
and
D. M. KELLEHER,
Attorneys for Respondent.

May, 1943.

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OPINION BELOW.

The opinion of the Circuit Court of Appeals (R. 27-38) is reported in 133 Fed. Rep. (2d) 131.

JURISDICTION.

The judgment of the Circuit Court of Appeals was entered on January 29, 1943 (R. 27). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED.

Respondent contends: That the question presented is whether the Board of Tax Appeals had jurisdiction to consider and apply the principle of equitable recoupment as a defense to an apparent deficiency for the fiscal year 1936, where the deficiency resulted from the reduction of the taxpayer's 1936 opening inventory identical with the closing inventory for the preceding tax year, thus automatically reducing the liability for 1935 taxes previously paid; and where the inventory reduction decreased the 1935 tax liability by a sum greater than the apparent deficiency for 1936; and where the "equitable reason", known as the right of recoupment, arose out of and inhered in one and the same transaction as the claim for deficiency, thus constituting a complete defense to the claim which would be sustained in a court proceeding. Unlike a demand for refund, the defense of recoupment when supported by the facts is not barred by the limitations statute.

STATUTES INVOLVED.

The statutes involved are set forth in the appendix *infra*. pp. 13, 14.

STATEMENT.

The Board of Tax Appeals found that the adjustment of an error in taxpayer's June 30, 1935 inventory, common to successive fiscal tax years 1935 and 1936, warranted the Commissioner's determination of a deficiency for 1936. (R. pp. 13-14) The error adjusted by a change in inventory figures, amounted to $237,104.33. The correction of the error not only resulted in a deficiency for 1936 of $6,663.42, but also, as the Board found, showed there had been "an overassessment for the fiscal year 1935 in the sum of $7,935.58", an amount greater than the 1936 deficiency. This the taxpayer had paid (R. 20 and R. 21-22). As the same inventory which contained the error was the closing inventory for

1935 and the opening inventory for 1936, the adjustment determined upon automatically affected the amount of tax liability for both years, reducing that for 1935, increasing that for 1936.

To arrive at a determination that there was a deficiency for 1936, both the Commissioner and the Board reduced the amount of the June 30, 1935 inventory. Without such reduction there would have been no 1936 deficiency. Respondent presented the issue that as the deficiency for 1936 sprang from the changed inventory figures, which change also automatically reduced the 1935 tax liability, a right of recoupment was available as a defense to the 1936 deficiency claim.

The Revenue Agent's report showed an over-assessment for 1935 of $7,935.59 (R. 20) which was accepted by the Commissioner and is stated in the findings of the Board (R. 14). Although there also were overpayments for tax years preceding 1935, due to inventory errors, they need not be considered, as the overpayment for 1935 alone exceeds the 1936 deficiency. The transaction relied upon to establish the defense of recoupment was the determination by the Commissioner and redetermination by the Board of the reduction of the June 30, 1935 inventory common to the consecutive tax years 1935 and 1936.

Further proceedings before the Board (now The Tax Court of the United States), if no new issues are presented by the Commissioner, as for example that other taxes are owing by Respondent, should present no greater difficulty than would arise if the defense of recoupment was sustained in a court proceeding involving the same claim of liability for a tax deficiency. No question has been raised by Petitioner as to correctness of the tax overpayment found by the Board for 1935.

ARGUMENT.

I.

It is contended for Respondent that equitable recoupment is a defense and not, like a claim for refund, an affirmative demand. And that both the Commissioner and the Board should have sustained the defense as one arising out of and inhering in the transaction on which is based a determination of a tax liability for 1936. The facts sustaining the recoupment claim are not in dispute, and appear in substance in the findings of the Board. The facts which establish the defense of recoupment had their origin in the same transaction and subject matter, as the apparent 1936 deficiency claim. The defense of recoupment inhered in the transaction which was the basis for the deficiency claim. There was such direct connection between the tax liability for the consecutive fiscal years 1935 and 1936, in which the same inventory was a basic factor in computing the tax for each of said years, that when the adjustment was made of the June 30, 1935 inventory, the act of reducing the inventory established the defense of recoupment to the resulting apparent deficiency for 1936. This is not to say, as petitioner assumes, that the adjustment merely established an affirmative right to demand a refund for the overpaid 1935 tax, no longer available because of the limitation statute. The facts and circumstances establish a complete defense to the 1936 deficiency tax claim.

The right of equitable recoupment is not a set-off or counterclaim, but an equitable reason which inheres in the transaction out of which the deficiency claim springs and is strictly a defense.

> *Williams* v. *Neely*, 134 Fed. Rep. 1, 5.
> *Crossett Lumber Co. et al.* v. *United States*, 87 Fed. Rep. (2d) 930, 933.
> *Stone* v. *White*, 301 U. S. 532.
> *Bull* v. *United States*, 295 U. S. 247.

Questions of liability for taxes are governed by equitable standards. Without regard to the bar of limitations stat-

utes, defenses inhering in the facts to be weighed in determining whether a tax debt is owing, open the door to the defendant "to show any state of facts which according to those standards would deny the right."

Stone v. *White*, 301 U. S. 532, 81 L. Ed. 1265.
Bull v. *United States*, 295 U. S. 247, 79 L. Ed. 1421.
Crossett Lumber Co. et al. v. *United States*, 87 Fed. Rep. (2d) 930, 933.
Mills v. *United States*, 35 Fed. Supp. 535.
Dixie Margarine Co. v. *Commissioner*, 115 Fed. Rep. (2d) 445.

While recoupment cannot be made a vehicle to carry an affirmative demand barred by limitations, such as a claim for refund, it is available as a defense to a new tax demand which arises out of the same transaction.

Dixie Margarine Co. v. *Commissioner*, 115 Fed. Rep. (2d) 445.
Crossett Lumber Company et al. v. *United States*, 87 Fed. Sup. Rep. (2d) 930, 933.
Bull v. *United States*, 295 U. S. 247, 79 L. Ed. 1421.

II.

There is as direct connection "between income taxes paid in successive years based upon a single erroneous inventory as there was between the estate tax erroneously determined and income tax correctly determined on the same item in *Bull* v. *United States, supra.*" *Crossett Lumber Co.* v. *United States*, 87 Fed. Rep. (2d) 930, 933.

Had the petitioner paid the 1936 deficiency and sued to recover, it is a fair inference from the position taken by counsel for the Commissioner in the Court of Appeals and here, that the legal sufficiency of the recoupment claim would be conceded. It is our contention that the Commissioner in the first instance should not determine that a deficiency exists if such determination would be reversed by a court called upon to review the finding and decision of the Commissioner. It is not conceivable that Congress intended

the officials charged with administrative duties should make determinations which, when challenged in a court, would be subject to reversal because contrary to the legal rights of the taxpayer.

The Board of Tax Appeals was created for the express purpose of enabling the taxpayer to obtain by an appeal to the Board, correction of the Commissioner's errors, and thus make it unnecessary to pay the tax and sue the Collector for the amount erroneously exacted.

"The sections creating the Board and investing it with power can leave no doubt that they were intended to confer upon it appellate powers which are judicial in character." *Blair* v. *Osterlein Machine Co.*, 277 U. S. 551.

"The provisions of law concerning the Board show that it is, when appealed to by a taxpayer, to have full and unimpeded authority to redetermine the taxes for the tax year, and its decision is to be final, subject to the review allowed before the Circuit Court of Appeals. The taxpayer who elects to invoke the jurisdiction of the Board accepts this consequence." *Cook* v. *United States*, 108 Fed. (2d) 804, 806.

Section 284(d), Revenue Act of 1926, 44 Stat. 66, providing that after a petition is filed with the Board in response to a deficiency notice, "No suit by the taxpayer for the recovery of any part of such tax shall be instituted in any court * * *", is therefore intended to make the Board the sole arbiter of the rights of the parties once an appeal is taken. To hold that a taxpayer taking such an appeal to establish his defense of recoupment unwittingly waives the defense by his appeal attributes to Congress a purpose which could never have been intended.

III.

Section 272 (g), Revenue Act of 1934, c. 277, 48 Stat. 680, requires that the Board "in redetermining a deficiency in respect of any taxable year shall consider such facts with relation to the taxes for other taxable years as may be necessary correctly to redetermine the amount of such deficiency * * *."

Respondent contends that the affirmative duty imposed by the quoted words required the Board in redetermining the claim of a 1936 deficiency to give effect to the facts disclosing a defense to the claim. And that the taxpayer's right to the benefit of the defense is not nullified by the further words in the nature of a proviso, "but in so doing shall have no jurisdiction to determine whether or not the tax for any other taxable year has been overpaid or underpaid." That the power of the Board to investigate and consider the facts with respect to June 30, 1935 inventory included the power to determine the effect of a reduction of the inventory where the reduction itself resulted in a defense to the deficiency. The 1936 deficiency could not be determined or redetermined without disclosing the existence of the defense. Substance and not form is the controlling principle, and the determination of a defense to the deficiency claim would not violate the letter of the statute.

In this case the June 30, 1935 inventory was a fact related in the same way to the taxes for both the year 1935 and 1936. The Board did consider that fact and the effect of the reduction in the amount the inventory, from which it appeared and was so determined that the correction of the inventory proved that the Treasury had in its hands as a result of the overassessment for 1935 and payment by the taxpayer, an amount greater than the apparent 1936 deficiency resulting from the change in the figures of the inventory. If these facts constituted a good legal defense to the apparent deficiency, the Board had the power to so determine. It had jurisdiction in redetermining the 1936 deficiency to declare there was no deficiency.

Jurisdiction under the statute was vested in the Board to consider the facts "with relation to the taxes" for 1935, if such consideration had a bearing upon the performance by the Board of its duty "correctly to redetermine" the amount of the 1936 deficiency. In the exercise of this jurisdiction, the Board did consider these facts "with relation to the taxes" for 1935. The identical inventory which was the taxpayer's closing inventory for 1935 and opening inven-

tory for 1936 was one of the facts considered. The facts and Board's findings establish the existence of an equitable reason which inhered in the same transaction out of which the apparent deficiency claim springs, constituting a defense to the 1936 deficiency. The claim for a 1936 deficiency and the defense to the claim called the right of recoupment, have their origin in the same transaction—the erroneous inventory. The deficiency claim itself sprang from and inhered in the inventory adjustment which, when adjusted, established the taxpayer's right of recoupment.

When the Commissioner determined, and the Board redetermined, the June 30, 1935 inventory, the consequences which followed should not be viewed as split in two unrelated parts, and given effect as creating a 1936 tax demand or debt and ignored as establishing a legal defense to the same debt. The power conferred upon the Board to "consider facts with relation to the taxes for other taxable years" must mean the power to consider the effect of such facts as a defense to an apparent deficiency for the year under investigation. Unless such facts had some effect upon the taxes for the year under investigation, their "consideration" would be futile. If given any effect, they should be given every effect the principles of law recognize. If the facts reduce the deficiency or reveal a full legal defense, that result is within the power of the Board to find and declare. As the opinion of the Court of Appeals states, the Board may not order a refund, and no determination that a refund be ordered was sought. It was only necessary for the Board to determine whether the apparent deficiency and the legal right to recoupment had a common origin or source, which in this case was apparent on the face of the transaction.

IV.

It is the theory of the Board and the Petitioner that a taxpayer having a good legal defense to an apparent deficiency under the principle of recoupment, and who files his petition

for a redetermination by the Board of Tax Appeals in order that his defense be upheld, paradoxically, thereby waives that defense. The taxpayer's right to the benefit of his defense, available in a court, is sought to be distinguished from the same right when asserted in a proceeding before the Board. To sustain this contention, it is assumed that the right of recoupment is not in fact a defense, but an affirmitive demand, if recoupment is asked in a proceeding before the Board. Facts which in a similar controversy in a court establish a defense to the deficiency claim are thus to be regarded as of no effect except to show the existence of a barred claim for refund. To justify this position it is argued that recoupment cannot be considered if the taxpayer files with the Board a petition for redetermination, instead of proceeding as was required before the Board was created, notwithstanding the decision to the contrary in *Dixie Margarine Co.* v. *Commissioner*, 115 Fed. Rep. (2d) 445, 447. In that case upon a petition to review the Board's decision involving the application of the principle of recoupment it was held: "The Board had no occasion to consider whether the statute of limitations affected the availability of petitioner's claim in recoupment. We think it did not."

The petition for the writ cites certain decisions to sustain the contention that "Congress has provided, and this and other courts have * * * long considered that the Board has no power to apply the doctrine of recoupment * * *". *United States ex rel. Girard T. Co.* v. *Helvering*, 301 U. S. 540, is cited. That was a mandamus action to command a refund of a tax in which the jurisdiction of the Board to adjudicate the deficiency there determined was sustained, but such determination was held not to support an action in mandamus to compel a refund, viz: "The Board is without authority to order a refund or a credit, although its decision is res judicata as to the questions involved in the computation and assessment of taxes for which a deficiency is claimed."

Among the reasons for refusing mandamus, the Court in that case said that other taxes may be owing by the

taxpayer, or there may be other reasons why the taxpayer is not equitably entitled to be paid the amount of the refund as computed and determined by the Board. It is open to the Commissioner here to present that issue on the remand for further proceedings, if any facts warrant such issue in this action. The possibility of such issue should not prevent the Board from applying the principle of recoupment to the 1936 deficiency claim.

Commissioner of Internal Revenue v. *Forest Glen Creamery Co.*, 98 Fed. Rep. (2d) 968, also cited, turned upon the sufficiency of the Commissioner's deficiency notice to the taxpayer. Reversing the decision of the Board and holding that the deficiency notice was sufficient, the Court merely prefaced its decision on that point with a quotation from the Revenue Act of 1926, Sec. 274 (g), 44 Stat. 55, as follows: "When the Commissioner of Internal Revenue has determined a deficiency against a taxpayer for a taxable year the Board of Tax Appeals has no jurisdiction 'to determine whether or not the tax for any other taxable year has been overpaid or underpaid'."

There is no opinion of the Court of Appeals in *Greenleaf Textile Corp.* v. *Commissioner*, 65 Fed. (2d) 1017, also cited. The grounds for the affirmance of the decision of the Board in that case do not appear in the reported decision.

The decisions of the Board are reviewable by the Circuit Courts of Appeals, which are by the statute given power "if the decision of the Board is not in accordance with law, to modify or to reverse the decision of the Board." Revenue Act of 1926, Sec. 1003, 44 Stat. 110. Thus the intention of Congress is clear that the decisions of the Board are subject to reversal if not "in accordance with law". A defense which a court would sustain should be sustained by the Board.

The right of recoupment is as much a legal defense when established by the facts as any other defense, and is not barred by the limitations statutes which bar a claim for refund. As the Court in *Stone* v. *White*, 301 U. S. 532, said:

"The statutory bar to the right of action for the collection of the tax does not prevent reliance upon a defense which is not a set-off or a counterclaim, but is an equitable reason, growing out of the circumstances of the erroneous payment, why petitioners ought not to recover."

"If there is a deficiency assessment, the jurisdiction of the Board extends to the whole controversy, to the end that it may determine or redetermine the correct amount of the tax." *Houston Street Corp.* v. *Commissioner*, 84 Fed. Rep. (2d) 821, 822.

The proceeding for redetermination by the Board "is in nature similar to and is of equal formality with a suit to recover a tax paid." *Bishoff* v. *Commissioner of Internal Revenue*, 27 Fed. Rep. (2d) 91, 93

When the Board's jurisdiction is properly invoked, it "Has power to revise legal errors of the Commissioner whether they be for or against the taxpayer." *Champlin* v. *Commissioner*, 78 Fed. Rep. (2d) 905, 907.

In view of the purpose for which the Board is established, "it has equal power to do full justice to the parties" that a court would have. *Helvering* v. *Edison Securities Corp.*, 78 Fed. Rep. (2d) 85, 91.

The Board "is an executive or administrative Board, exercising powers judicial in character." *Garden City Feeder Co.* v. *Commissioner*, 75 Fed. Rep. (2d) 804, 806.

"If there is a deficiency assessment, the jurisdiction of the Board extends to the whole controversy, to the end that it may determine or redetermine the correct amount of the tax." *Peerless Woolen Mills* v. *Rose*, 28 Fed. Rep. (2d) 661, 662.

In this case the Board erroneously refused to sustain the defense of recoupment, and, though citing among other cases, *Dixie Margarine Co.* v. *Commissioner*, 115 Fed. Rep. (2d) 445, which reversed the Board for not applying the principle of recoupment, said:

> "None of the above court cases hold that the Board has jurisdiction to consider the doctrine of equitable

> recoupment with respect to statutory deficiencies. The Board itself has held that it has no authority under the limited jurisdiction conferred upon it to apply the principles of recoupment." (R. 14)

The Court of Appeals held that such limitation upon the Board's powers was unwarranted.

The fear of Petitioner that the statutes limiting the jurisdiction of the Board are being destroyed is groundless. The Respondent is merely asking that in their interpretation well established equitable principles be applied to prevent the exaction of a debt it does not owe, and which is barred from refund if such exaction is permitted.

CONCLUSION.

The decision of the Court below was correct; the petition raises no question entitling Petitioner to the review asked.

Respectfully submitted,

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and
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May, 1943.

APPENDIX.

Revenue Act of 1934, c. 277, 48 Stat. 680, provides:

SEC. 272. PROCEDURE IN GENERAL.

(a)(1) Petition to Board of Tax Appeals.—If in the case of any taxpayer, the Commissioner determines that there is a deficiency in respect of the tax imposed by this chapter, the Commissioner is authorized to send notice of such deficiency to the taxpayer by registered mail. Within ninety days after such notice is mailed (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day), the taxpayer may file a petition with the Board of Tax Appeals for a redetermination of the deficiency. * * *

* * * * * * * * * * *

(b) Collection of Deficiency Found by Board.—If the taxpayer files a petition with the Board, the entire amount redetermined as the deficiency by the decision of the Board which has become final shall be assessed and shall be paid upon notice and demand from the collector. No part of the amount determined as a deficiency by the Commissioner but disallowed as such by the decision of the Board which has become final shall be assessed or be collected by distraint or by proceeding in court with or without assessment.

* * * * * * * * * * *

(e) Increase of Deficiency After Notice Mailed.—The Board shall have jurisdiction to redetermine the correct amount of the deficiency even if the amount so redetermined is greater than the amount of the deficiency, notice of which has been mailed to the taxpayer, and to determine whether any penalty, additional amount or addition to the tax should be assessed—if claim therefor is asserted by the Commissioner at or before the hearing or a rehearing.

* * * * * * * * * * *

(g) Jurisdiction Over Other Taxable Years.—The Board in redetermining a deficiency in respect of any taxable year

shall consider such facts with relation to the taxes for other taxable years as may be necessary correctly to redetermine the amount of such deficiency, but in so doing shall have no jurisdiction to determine whether or not the tax for any other taxable year has been overpaid or underpaid.

Revenue Act of 1926, c. 27, Sec. 1003 (a) and (b), 44 Stat. 110, provides:

Courts of Review.—(a) In General. The Circuit Courts of Appeals and the United States Court of Appeals for the District of Columbia shall have exclusive jurisdiction to review the decisions of the Board, * * *

* * * * * * * * * * *

(c) Powers—(1) To affirm, modify, or reverse. Upon such review, such courts shall have power to affirm or, if the decision of the Board is not in accordance with law, to modify or to reverse the decision of the Board, with or without remanding the case for a rehearing, as justice may require.